

# MICHIGAN'S PATH FORWARD

## Fiscal Year 2011 Executive Budget

Governor Jennifer M. Granholm's 2011 Executive Budget continues her administration's efforts to move Michigan forward with investments in education and comprehensive reforms that will help to address the current and future needs of nearly ten million citizens. This budget is focused on ensuring that our citizens' most important priorities – education, jobs, health care and protecting families – remain our collective pledge.

We are at a critical point in our state's history. Michigan's economy has undergone a fundamental transformation. Nearly a million jobs have been lost since the last decade began. Two of our major automotive companies have entered and emerged from bankruptcy. Other businesses continue to struggle in the midst of a prolonged national recession.

Michigan is not alone in facing these profound challenges, however, and is just one of many states dealing with the impacts of the worst economic downturn since the Great Depression.

The National Governors Association and the National Association of State Budget Officers (NASBO) report that states face \$256 billion in budget gaps between fiscal years 2009 and 2011, largely brought on by drastically reduced tax revenues.

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*"These are the worst numbers we've ever seen in the decades of putting together this report. States have been forced to lay-off and furlough employees, raise taxes, drain rainy day funds and sharply cut state spending . . ."*

**Scott D. Pattison, NASBO Executive Director, referring to The Fiscal Survey of States published in November 2009**

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And, yet, it is during this time of protracted economic crisis that the demand for state services is most critical.

Balancing the state budget in the face of falling state revenues, and the increased demand for services has been a foremost challenge. Governor Granholm has repeatedly cut spending, implemented efficiencies and enacted reforms to protect critical services. Even with these efforts, the state budget continues to present an on-going challenge.

Federal recovery assistance has stabilized the state budget in the short-term, and will continue at a reduced level in fiscal year 2011. These one-time resources will eventually run out, however, and the action policymakers take with respect to this budget will dictate how Michigan moves forward in the absence of these federal resources in the future.

Governor Granholm, in her final budget, presents aggressive reforms that continue her commitment to education and provide for long-term savings to address the fiscal challenge and preserve the priorities that matter most to citizens.

This budget provides solutions that further reduce spending, implement additional government reforms, restructure an antiquated tax system, and help businesses to be more competitive. It provides for necessary investments in education to ensure our children's future and to prepare our citizens for new careers.

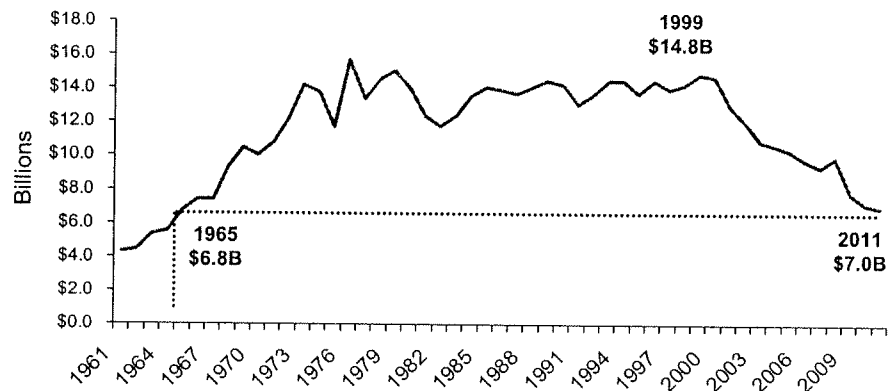
## Michigan's Budget Challenge

Michigan has experienced unprecedented revenue declines in the wake of the national economic recession. Since 2002, state revenues adjusted for inflation have fallen by over 41 percent. General fund revenues in nominal terms have fallen back to 1991 levels, and, when adjusted for inflation, are consistent with revenue levels last seen in 1965 – a 46 year low.

Even as the national economy begins to show preliminary signs of recovery, experts indicate Michigan will not recover as quickly or completely as other states due to the significant

transformational changes that have occurred to our economy. Consequently, state revenues are expected to continue to lag at these sharply reduced levels for a prolonged period.

### Inflation Adjusted GF-GP Lowest Since 1965



Note: GF-GP figures are presented on a Consensus basis and adjusted for inflation to 2011 dollars using the state and local government price deflator. FY 2010 & FY 2011 are the Jan 2010 Consensus estimates.

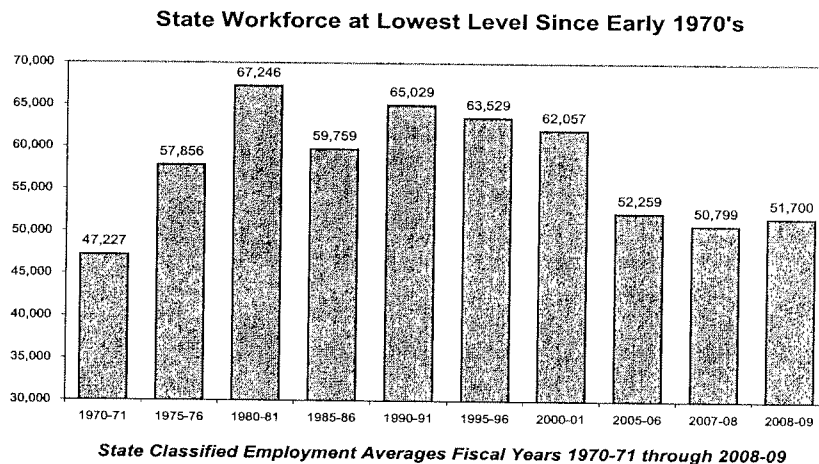
At the same time, unavoidable spending pressures continue, largely reflecting the demand for services from those citizens most directly impacted by the economic recession. Increased numbers of people eligible for Medicaid, growing family assistance caseloads, along with rising health care costs and pension obligations all contribute to the budgetary pressures.

Governor Granholm has taken significant steps to address Michigan's on-going budget challenge. Forty-seven executive directives have been issued to limit state spending. Over \$10 billion in budget deficits have been resolved. General fund expenditures are nearly 34 percent below the rate of inflation during the period from 2001 to 2010.

Eight prisons, 10 corrections camps, 6 residential care facilities and a state hospital have been closed. Five departments have been eliminated, including the Department of History, Arts and Libraries. Nearly 300 obsolete state boards and commissions have been trimmed, and support for the State Fairs in Detroit and Escanaba has been discontinued.

The Department of Corrections has achieved nearly \$600 million in savings and reforms, lowering the prison population largely due to a successful Michigan Prisoner Re-entry Initiative that is helping to reduce costly recidivism.

The state workforce has over 10,300 or 17 percent fewer employees than it did in 2001, and now has the lowest number of employees since 1973. Employees have contributed over \$650 million in economic concessions, including unpaid days off, increased health insurance premiums, and deferred pay, while workloads have increased.



Many of the recommendations of the Legislative Commission on Government Efficiency have already been adopted or are being implemented, including significant cost saving reforms in the areas of health care, employee benefits, service consolidations and operational efficiencies.

Additionally, over \$71 million in surplus state property has been sold. Lease savings of \$157 million have been achieved, and over 600,000 square feet of state office space has been consolidated. Energy usage in state facilities has been reduced by 23 percent. Contract savings have been negotiated with vendors. Enhanced recovery efforts have been implemented to combat fraud and abuse of state programs and to collect delinquent tax obligations. And, additional revenue has been provided through business and individual tax changes.

Despite all of these efforts, a budget imbalance remains that will not be completely resolved in this budget cycle or with a strategy that relies solely on a one-sided solution. It will require a comprehensive set of solutions – both short-term and long-term – to resolve this problem while continuing to meet the needs of Michigan's citizens.

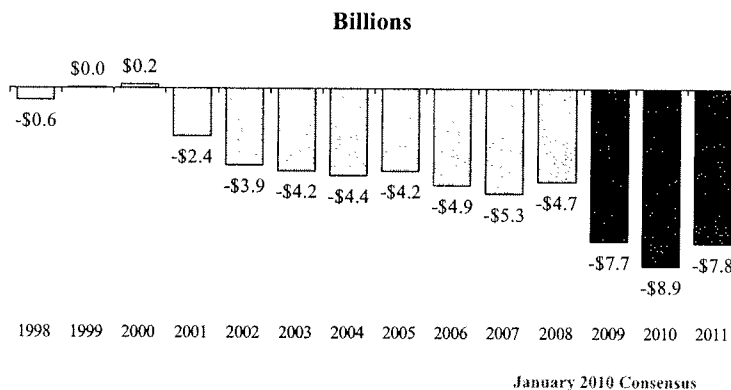
The fiscal year 2011 budget presented today is balanced, and should be supported with the confidence that it takes a fundamental step forward in addressing the budget challenges that remain. It offers stability for our schools so they can stay focused on the task of educating children. It provides for reforms that will make government more efficient and cost effective for the taxpayer in the long run, and through tax changes and restructuring, it creates a more conducive environment for businesses to grow and create jobs.

## State Revenue Forecasting and Spending Limits

State law requires two revenue estimating conferences each year, typically held in mid-January and mid-May. Conferees include the State Treasurer and the directors of the Senate and House fiscal agencies. The conferees agree on baseline revenue estimates for the current year and the upcoming fiscal year for both the general fund and the School Aid Fund. The January conference provides the revenue estimates for the Governor's budget recommendation presented in February. For fiscal year 2011, the conferees project combined general fund and School Aid Fund revenues that total \$17.4 billion, a decline of \$839 million or 4.6 percent from fiscal year 2009.

Michigan has a constitutional provision that limits revenue growth from year to year. Michigan's constitutional limitation – commonly known as the Headlee amendment – has been in place since 1978. The Headlee amendment limits annual growth in state revenues to a level that cannot exceed the year-to-year growth in personal income. This limit is intended to ensure that the state's overall revenues, both tax and non-tax revenues, do not grow faster than the incomes of Michigan's citizens.

## State Revenues are \$7.8 Billion Below the Constitutional Revenue Limit



It is anticipated that state revenues for fiscal year 2011 will be \$7.8 billion below the constitutional revenue limit. This gap has grown as a result of the economic downturn and is anticipated to widen further as currently enacted tax changes take effect in the next several years.

## Fiscal Year 2010....Where We Stand

Like other states, Michigan's current year budget has relied heavily on economic recovery revenues provided by the federal government through the American Recovery and Reinvestment Act. This unprecedented assistance, over \$11.4 billion at last count, has come in the form of traditional formula programs, competitive grants, direct assistance to business and individuals, targeted investments in infrastructure and new technologies, and fiscal relief for state government and schools.

In fiscal year 2010, the general fund is supported with \$1.1 billion in economic recovery revenues. Likewise, the School Aid Fund is bolstered by \$450 million that has helped to keep teachers in the classroom.

The budget for the current year also contains spending cuts totaling over \$1.2 billion, resulting from dramatic reductions to mental health services, local revenue sharing, college scholarships, K-12 education and other important programs supporting state and local services.

As a result of the support from the federal government and the aforementioned reductions, both the general fund and the School Aid Fund are balanced in the current year. No action is necessary at this time to reduce the current year spending plan. Revenues and expenditures will be closely monitored during the remainder of the year and should the fiscal calculus warrant, adjustments will be proposed.

# Fiscal Year 2011 Executive Budget Recommendation

The January Consensus Revenue Estimating Conference projected revenues will be \$6.97 billion for the general fund and \$10.48 billion for the School Aid Fund in fiscal year 2011.

As a result of unavoidable spending pressures and revenue projections that assume only modest growth from sharply reduced levels, the fiscal year 2011 budget begins with a combined general fund and School Aid Fund gap of \$1.5 billion.

<b>Fiscal Year 2011 Revenue and Spending</b> (\$ in millions)			
	<b>GF/GP</b>	<b>School Aid Fund</b>	<b>Combined</b>
Beginning Balance	\$34	\$79	\$113
Consensus Revenues	\$6,968	\$10,481	\$17,449
Revenue Sharing Savings	\$427	\$0	\$427
Use Tax - 2009 PA 106	\$355	\$0	\$355
Interfund Transfers	\$45	\$30	\$75
Federal Aid to Schools	\$0	\$1,863	\$1,863
<b>Total Revenue Estimate</b>	<b>\$7,829</b>	<b>\$12,453</b>	<b>\$20,282</b>
FY 10 Current Law Spending	\$8,128	\$12,824	\$20,952
Baseline Spending Adjustments			
Corrections Prison Increases	\$26	\$0	\$26
Replace FY 2010 Federal Stimulus Revenue	\$1,057	\$0	\$1,057
FY 2011 ARRA Funding (one quarter)	(\$208)	\$0	(\$208)
Community Health Baseline	(\$184)	\$0	(\$184)
Human Services Caseload/Costs	\$118	\$0	\$118
Federal Matching Rate Adjustments	(\$232)	\$0	(\$232)
Employee Economics	\$140	\$0	\$140
Other Cost Adjustments	\$71	\$39	\$110
<b>Total Baseline Spending Estimate</b>	<b>\$8,916</b>	<b>\$12,863</b>	<b>\$21,779</b>
<b>Projected Funding Gap</b>	<b>(\$1,087)</b>	<b>(\$410)</b>	<b>(\$1,497)</b>
Spending Reductions and Reforms	\$566	\$0	\$566
Revenue Adjustments and Reforms	\$12	\$562	\$574
FY 2011 Federal Stimulus (two additional quarters)	\$514	\$0	\$514
<b>Total FY 2011 Funding Surplus</b>	<b>\$5</b>	<b>\$152</b>	<b>\$157</b>

This budget assumes \$722 million for three quarters of federal recovery assistance that can be used to close this gap in fiscal year 2011 via an increase in the Federal Medical Assistance Percentage (FMAP) rate. Only one quarter of funds is presently guaranteed; funding for the additional two quarters are included in President Barack Obama's proposed fiscal year 2011 federal budget that is currently before Congress.

The Governor's budget proposes a number of comprehensive reforms and spending reductions, as well as the restructuring of an antiquated tax system to address the remaining budget shortfall. The Governor calls on the Legislature to give these critical reforms their quick attention in order to bring stability to schools and to avoid delay in implementing reforms that will generate long-term savings.

## **Transforming the Way Government Does Business**

First, the Governor's budget recommendation builds on efficiencies already implemented, including new reforms in the areas of corrections, employee benefits and pensions, health care, government operations and the budget process.

- The budget reforms state and public school employee pension obligations in order to constrain costs and achieve savings of \$7.8 billion over 10 years by:
  - eliminating vision and dental coverage for future retirees;
  - requiring employee contributions to help offset growing pension obligations;
  - capping employee participation in the defined benefit retirement plans at thirty years, and thereafter transferring employees to a defined contribution plan;
  - modernizing the retirement system for new public school employees by combining the benefits of the traditional defined benefit and defined contribution plans into a new hybrid plan that will provide long-term savings to schools;
  - introducing a phased retirement option whereby an eligible employee can retire and receive pension benefits while continuing to work reduced hours for a limited period of time;
  - providing a modest incentive for employees eligible to retire;
  - limiting the number of new hires to permanently downsize state government.
- Recently negotiated employee concession agreements will implement additional long-term reforms. New employees hired after April 1, 2010, will assume an even greater share of health insurance costs under the new State Health Plan. The Governor also proposes that the Civil Service Commission allow schools and local governments to participate in this new cost-effective state plan.
- The budget assumes the elimination of the 3 percent salary increase due in fiscal year 2011 for non-exclusively represented employees, contingent upon approval of the Civil Service Commission on February 10, 2010. This elimination impacts approximately 27 percent of the state workforce.
- The Governor recommends sentencing reforms that will result in a reduced prisoner population, the closure of additional facilities and further operational efficiencies. These reforms reinstate a form of sentencing credit for good behavior and allow for reinstatement of community residential programs, a less costly alternative to prison incarceration for carefully screened offenders. The Governor recommends consideration and passage of House Bills 4497, 4498 and 4499 that implement these reforms.

- The recommendation continues implementation of child welfare reforms in the Department of Human Services to improve services for children and families, including hiring additional protective service caseworkers to ensure child safety. Eligibility for the foster care, adoption subsidy and subsidized guardianship programs will be extended from age 18 to 20. Upgrades to the child welfare information technology system will support outcome-based case management. With this recommendation, the Governor has committed over \$166 million to these improvements over the last four years.

- This budget restores the Michigan Promise, converting it to a new refundable \$4,000 tax credit for those who complete their degree and work for one year in Michigan. Also, the Michigan State Police Survivor Tuition Program is consolidated with other scholarship programs in the Department of Treasury.

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*"Our limited resources are further diminished by a state government that was designed in the 1960's. And that has to change."*

**Governor Jennifer M. Granholm**  
**January 29, 2010**

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- The Governor's budget ends pharmaceutical immunity and allows Michigan residents to bring suit against a drug manufacturer for injury caused by a Federal Drug Administration approved pharmaceutical. Due to a 1996 law, Michigan is the only state that shields drug manufacturers from product liability. Settlement revenues generated by beneficiary lawsuits would offset Medicaid costs.
- A new Office of Health Services Inspector General is established to audit and investigate health care providers and Medicaid beneficiaries suspected of misusing Michigan's Medicaid program, with recoveries used to help offset medical services costs.
- A total of \$5 million in additional lottery revenue is generated for the School Aid Fund via expanded advertising, airport sales and more efficient claimant procedures. These funds are in addition to \$38 million in new revenues from the Powerball game that was recently introduced.
- The budget further streamlines state government by implementing Executive Orders 2009-45 and 2009-55 that combine the departments of Natural Resources and Environmental Quality, and the departments of Information Technology and Management and Budget.
- The consolidation of school services is recommended in order to reduce district operational costs, including: requiring competitive bidding on contracts; establishing statewide contracting and procurement consortiums; requiring sharing of non-academic services; improving the binding arbitration process; and allowing local governments and schools access to the state's new health care plan.

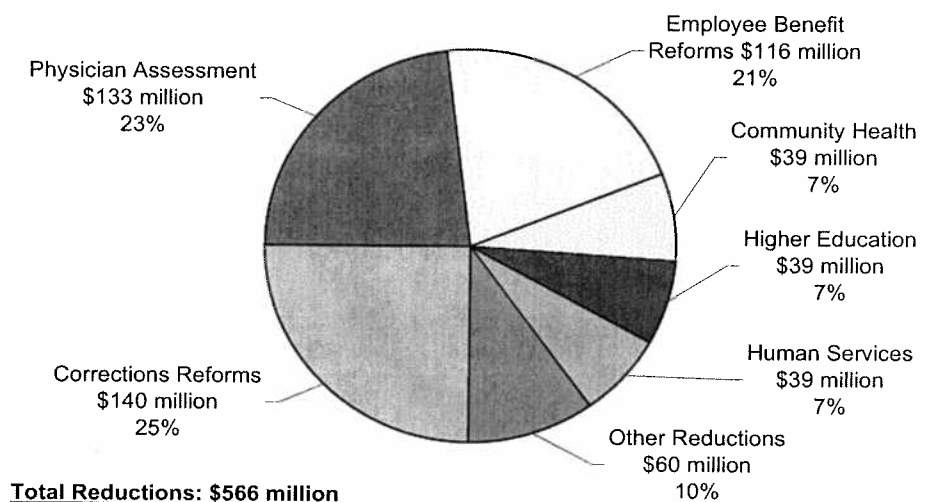
- The Governor also proposes budget process reforms to ensure the state budget is enacted on time, within available revenues, and that all spending, whether via the budget or tax code, is consistently reviewed by the Legislature. Specific reforms include:
  - instituting a 2-year budget beginning with fiscal year 2012;
  - requiring a June 30 deadline for completion of all legislative action on the budget, including the passage of all legislation needed to implement the budget;
  - requiring a two-year sunset for all tax expenditure credits; in the year that the Legislature is not enacting a budget, the Governor and Legislature would review, reauthorize or revise tax expenditures in a manner similar to the appropriations process;
  - instituting a “pay as you go” provision for all budget and tax expenditures and additional disclosure regarding the fiscal impacts of legislation;
  - requiring book closing of the previous fiscal year by December 31, and incorporating more long-term forecasting and additional major spending areas into the revenue consensus and budget process;
  - retaining the current revenue consensus process, but calling for three conferences per year: January, May and September.

## Additional Spending Reductions

Second, the Governor recommends \$566 million in general fund spending reductions in fiscal year 2011, impacting every state department. These reductions include:

- \$140 million for corrections reforms that will reduce the prisoner population and allow for the closure of up to five additional facilities.
- \$133 million from a physician provider assessment that would increase state reimbursement rates to Medicaid participating physicians by 80 percent.
- \$116 million in employee benefit reforms that provide savings and help to ensure the Michigan State Employees’ Retirement System is fiscally sound, including \$98 million from pension reforms and \$18 million from the elimination of the 3 percent salary increase for non-exclusively represented employees.

**Fiscal Year 2011 General Fund Reductions**





The pension reforms are expected to result in the retirement of over 6,300 employees and the permanent downsizing of the state workforce.

- \$39 million in Higher Education resulting from the elimination of the Tuition Grant program for private college students and structural reforms to the Tuition Incentive program.
- \$39 million in Department of Community Health reductions, including increased nursing home transitions to community-based alternatives, service eliminations and enrollment freezes.
- \$39 million in the Department of Human Services reflecting program reductions and fund shifts to federal and other resources to help preserve critical services to families most in need.
- \$60 million in other reductions for state agencies, the legislature and the judicial branch.

The budget also includes \$475 million in spending reductions in the Department of Transportation to reflect available federal aid that will be lost to Michigan due to insufficient state transportation revenues. In total, \$528 million in federal funds are anticipated to be foregone by state agencies due to shrinking general fund and state restricted revenues that are limiting our ability to secure all available federal funds.

## **Tax Restructuring to Preserve Education and Create Jobs**

**L**astly, Governor Granholm proposes a significant restructuring of the tax system in order to address two fundamental issues confronting the state:

- School funding in fiscal year 2011 is inadequate, and without increased revenue the K-12 education system will face unavoidable additional cuts; and
- Michigan must fuel job creation and diversify the economy by making our state a more attractive place for business.

While Michigan's precipitous revenue declines are largely related to economic conditions resulting from the national recession, our antiquated tax system compounds the revenue loss and negatively impacts schools.

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*"Any serious stab at changing the state budget has to look at the receipts side of the ledger, too. Taxes need to be reformed. One solution with growing support is to expand sales taxes to services, the growing sector of the economy."*

**Grand Rapids Press Editorial Board**  
**January 6, 2010**

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The existing tax system is based heavily on an industrialized economy that no longer exists. The trend over the last several decades in Michigan, and other states, is toward a more service-based economy. In 1950, the sale of services in Michigan accounted for only 40 percent of consumer spending, that figure has now grown to over 66 percent. Unfortunately, our tax system has not kept pace with these economic changes, and must be reformed in order to recognize consumer activity that is more reflective of a diverse and global economy.

To restructure the tax system, Governor Granholm recommends lowering the existing state sales and use tax rates from 6 to 5.5 percent, while expanding the sales and use tax to consumer services.

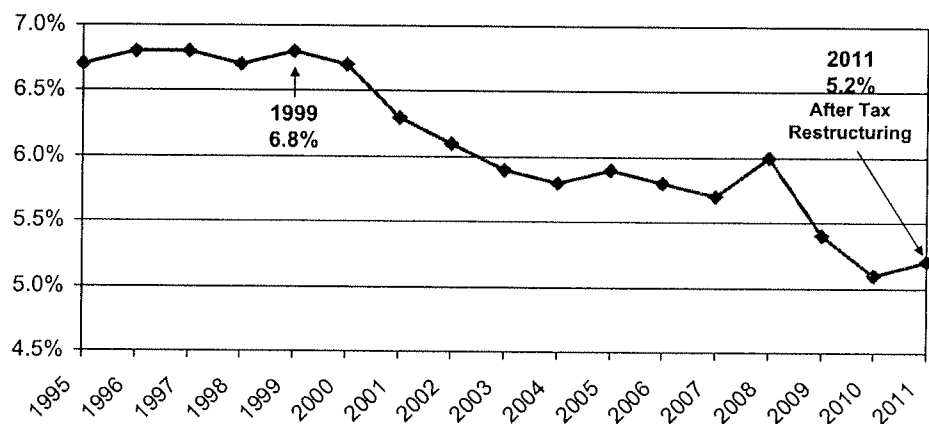
The restructured tax would include all consumer services, with exclusions for health care and social assistance, education, new construction, real estate and insurance commissions, and services directly connected to business operations.

The Governor's budget directs the revenue to the School Aid Fund to ensure we continue to invest in children and the educational priorities that will chart Michigan's path forward. These additional revenues will stabilize school financing in the short-term, providing a bridge while long-term reforms to school employee pensions and the consolidation of services take effect. Without these additional revenues, significant cuts to public schools will be unavoidable.

To spur job creation, Governor Granholm also calls for the elimination of the Michigan Business Tax (MBT) surcharge – cutting it in half in 2011, and phasing it out completely in 2012. The elimination of this surcharge along with additional phased reductions in the MBT's gross receipts tax rate from 0.8 to 0.6 percent (0.1 percent in 2012, and an additional 0.1 percent in 2013) will allow existing businesses to better compete, invest and create jobs. These tax cuts, totaling \$2.6 billion over the next four years, will also make Michigan an even more attractive destination for new businesses to locate.

Michigan currently ranks 31st, well below the national average, relative to tax revenue as a percent of personal income. In 1999, state revenues as a percent of personal income were 6.8 percent. In 2011, after enactment of the tax restructuring proposal, it will be only 5.2 percent.

**GF-GP & SAF Taxes Decline as a Percent of Personal Income**



The net revenue impact of this tax restructuring proposal is \$554 million in fiscal year 2011. This tax reform proposal is revenue neutral after the MBT surcharge and other tax changes are fully implemented.

# Preserving our Priorities

Despite further spending cuts and aggressive reforms to address the budget imbalance, the Governor's budget continues to support critical services and the priorities that matter most.

## Education, Training and Job Creation

The per pupil funding for K-12 education is maintained at fiscal year 2010 levels as a result of the Governor's tax restructuring reforms. The Great Start Readiness Program is also maintained, providing 28,000 academically at-risk children with preschool opportunities. Pension reforms will save \$5.8 billion for schools over 10 years, and although school funding is maintained at current levels in fiscal year 2011, these pension reforms will increase the spending power for schools long-term. In total, the Executive Budget contains \$12.9 billion to help fund our public schools, of which \$11 billion is state funds.

Funding totaling \$1.8 billion for university and community college operations is preserved at fiscal year 2010 levels as well, recognizing the critical role these institutions play in preparing our citizens for Michigan's new economy.

Although general fund resources for the No Worker Left Behind and Michigan Nursing Corps programs are eliminated, over \$648 million for these and other critical career education and re-training programs will continue to be available to address workforce needs with federal and other state support.

Funding for the 21st Century Jobs Fund is maintained at \$75 million to support job creation in the growing economic sectors of renewable energy, life sciences, homeland security and advanced manufacturing.

A total of \$13 million is added for the Pure Michigan campaign supported with rental car fees; a new funding source for this popular and effective tourism promotion program. The Governor calls on the Legislature to take action on House Bill 5017 that provides for this new funding.

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*"Government cannot afford to be all things to all people but must focus on the things that matter most: job creation, education and providing critical services to those most in need."*

**Governor Jennifer M. Granholm**  
**January 29, 2010**

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# Health Care and Protecting Families

**M**edicaid for Michigan residents is funded at \$11.5 billion, providing basic physical and mental health services to the poor, the elderly and the disabled. Currently, 1 in 6 Michigan residents receives health care through this program.

Improvements in Michigan's child welfare system are funded at \$39 million in fiscal year 2011. These funds support additional child welfare staff, a federally-required children's services automation system, and extending benefits to age 20.

To help cash assistance recipients prepare for the job market, \$33 million is invested over two years in the JET Plus program. These funds will focus on basic education and will help Family Independence Program recipients obtain employment.

The federally-funded Food Assistance Program will continue to increase to almost 2 million recipients in fiscal year 2011, representing 1 out of every 5 Michigan residents.

Revenue sharing payments to cities, villages and townships are maintained at the fiscal year 2010 levels. The Governor continues her commitment to restore county revenue sharing payments by including \$115 million to fully fund the 38 counties eligible in fiscal year 2011.

The budget maintains funding for Michigan State Police troopers at current strength, provides \$36.9 million for state crime laboratories, and recommends a fiscal year 2010 supplemental of \$2.5 million in order to reduce forensic case backlogs.

## Conclusion

**W**e are at a critical point in Michigan's history. The challenges faced by our citizens, businesses, state and local governments are unprecedented. Yet out of this challenge comes the opportunity for a New Michigan. To ensure that we emerge from this period a stronger, more competitive, more financially stable state will require focus, discipline and a willingness to make tough decisions.

Governor Granholm's fiscal year 2011 budget provides a comprehensive set of recommendations that further reduce spending, provide for additional government reforms, restructure an antiquated tax system, and help businesses to be more competitive. It provides for significant investments in education to stabilize school financing and ensure our children's future. It represents the fiscal discipline that is required to address the state's budget challenges, while continuing to provide the services citizens need most. This budget is the right solution for Michigan, and it sets us on the right path forward.